No. 11,046

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ESTATE OF ETHEL M. DUVAL, deceased, by THOMAS M. ROBINSON, JR., and WESTON SHATTUCK ROBINSON, as executors of her last will and testament,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONERS' CLOSING BRIEF.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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INTRODUCTORY STATEMENT.

Petitioners' opening brief challenged the decision of the Tax Court here under review.

We here present our comments on the points raised in respondent's brief.

(NOTE): All emphasis here is our own, unless otherwise stated.

THE ARGUMENT OF THE REPLY.

I.

THE CLAIM BASED ON THE GUARANTEES IS REAL AND ACTUAL AND NOT POTENTIAL BECAUSE THE LIABILITY IS ACTUAL.

Respondent's statement (Resp. Br. p. 10) that the claim is potential ignores *Reg. 105,* Sec. 81.36 which establishes the proposition that so far as liability is concerned, the basis for deductibility is the "*personal obligation* of the decedent existing at the time of his death, whether or not then matured."

The claim in this case satisfied the requirements of the California Probate Code because it was a debt or demand against decedent which could have been enforced against her in her lifetime by a personal action for the recovery of money upon which only a money judgment could have been rendered (11a *Cal. Jur.* p. 680, Sec. 485).

The claim under the California Probate Code was also an acknowledged debt of the estate and allowed by the laws of California within the meaning of Sec. 812(b)(3).

II.

THE FACT THAT THE CLAIM MIGHT NEVER BE PAID DID NOT MAKE IT "POTENTIAL" AND NON-DEDUCTIBLE BECAUSE LIABILITY AND NOT PAYMENT IS THE BASIS FOR DEDUCTIBILITY.

After having said at page 10 of the respondent's brief that the claim was "potential" and not actual, it is next said that "As such, *until it is paid* by the estate or it is *reasonably certain to be paid,* no deduction can be taken."

But, as we have shown at pages 17 to 19 of our opening brief, it is settled law under a long series of decisions, cited therein, under Sec. 812(b)(3) as it existed as of the date of decedent's death, that it is wholly immaterial that the claim may never be paid. The act does not so read and Congress did not so intend. Congress did not limit deductibility of claims in respect of their payment or payability.

We respectfully submit that these cases completely dispose of the argument that *payment or payability* of the claim has anything to do with deductibility.

Deductibility depends on *liability* to pay.

III.

THE TAX COURT ERRED IN ITS CONSTRUCTION OF A WRITTEN INSTRUMENT, FROM ITS LANGUAGE ALONE AND DISREGARDED THE UNCONTRADICTED EVIDENCE SHOWING WHAT THE PARTIES INTENDED BY THE INSTRUMENT AND THIS COURT IS NOT BOUND BY THE TAX COURT'S CONSTRUCTION AND MAY MAKE ITS OWN CONSTRUCTION THEREOF.

The actual decision of this case by the Tax Court shows that the Court was *construing the legal effect of a written instrument*—the consent to distribution, *from its language alone* and without any consideration of the uncontradicted evidence of the surrounding circumstances showing what was *intended* by that instrument. Thus the Tax Court ruled:

> "From the *tenor of the 'consent to distribution'* especially its specific reservation of the claim against the co-guarantor, *we conclude that as to petitioners*,

the bank had abandoned its claim and relinquished its right * * * " (T. 27-28).

The respondent's brief (p. 10) says:

"From the terms of the *letter* covering the consent to distribution (R. 57) surely the Tax Court was justified in drawing the conclusion that the bank had relinquished its claim against decedent (R. 28) * * *"

The letter of transmittal (T. 58) says:

"*In accordance with your request* we are enclosing consent to distribution in the above named estate * * *"

Since this consent was sent "*in accordance with your request*" and since the uncontradicted evidence is that the consent was *requested* so that the estate could be distributed *subject to the claim,* on what rational basis can it conceivably be concluded that the bank intended to *abandon* the claim and *relinquish* its right?

The evidence on this point is (T. 52-53):

"* * * I told him (i. e. the bank's Vice President) that the claim had been allowed by the Executors and would shortly be presented to the court for approval and that when it was allowed and approved the estate could not be distributed without the consent of the bank. I told him, as he had known, I was the residuary legatee named in Mrs. DuVal's will to whom the estate would be distributed in trust and *that our plan was to distribute the estate in trust subject to the bank's claim. I asked him if, on that basis, the bank would consent to distribution.*

He said that he believed it would and would let me know in the next day or two.

> On the 17th of March, on the day following, I received the letter counsel showed me, enclosing the consent to distribution and the withdrawal of special notice."

This uncontradicted evidence plainly shows that the consent to distribution was sent in response to a request based upon the proposition that the estate would be distributed *subject to the claim* and the conclusion, *based on the language of the consent alone,* that the bank abandoned its claim and relinquished its right simply lacks the support of the record.

Furthermore, the undisputed evidence is that on August 17, 1937, the M. K. Blake Estate Co. borrowed $162,000 from the bank (Resp. Br. p. 3); at that time and at the bank's request the guarantees were executed (Resp. Br. p. 4); on November 2, 1941, the Company borrowed another $20,000 from the bank and guarantees were again executed (Resp. Br. p. 4); both notes were guaranteed by decedent at the bank's request (T. p. 41); on August 20, 1941, decedent and her sister gave written consents to an agreement extending the maturity of the notes to August 2, 1944 (Resp. Br. p. 5); after decedent's death the bank presented its claim on the guarantees (Resp. Br. p. 5); the claim was delivered to the executors in June, 1942 (Resp. Br. p. 5); the letter from the bank transmitting the consent to distribution is dated March 17, 1943 (T. p. 57).

It is unthinkable that the claimant bank after having husbanded the decedent's liability on the guaranty from 1937 to March of 1943 should *voluntarily* abandon its claim and relinquish its right after having been requested

to consent to distribution of decedent's estate *subject to the claim,* but without payment thereof.

The Tax Court was not justified in interpreting the consent to distribution or the letter of transmittal as an abandonment or waiver.

Abandonment and waiver are matters of *intention* and there is no finding of fact by the Tax Court that any such abandonment or waiver was *intended.*

The Tax Court here has disregarded the uncontradicted evidence which shows what the parties intended and the Tax Court's error in *construing the legal effect* of the consent to distribution from its language alone is a clear cut error of law.

In *Lum v. Commissioner* (CCA-3) 147 F. (2d) 357, at page 358, the Court said, referring to the legal effect of certain assignments of lease:

> "This, * * * is not a question of fact, *but an interpretation of a written document, which the Court is free to construe for itself.*"

We respectfully submit that the Tax Court's interpretation of the consent to distribution, in the light of the facts and the law of California, as set forth in our opening brief and herein is without warrant of law and unsupported by the record.

IV.

ALL THAT BUCK v. HELVERING HELD WAS THAT "IF THE DEBT OF THE CORPORATION IS PAID BY THE CORPORATION BEFORE IT IS PAID BY THE STOCKHOLDER, THE LIABILITY OF THE STOCKHOLDER IS EXTINGUISHED".

Respondent's brief (p. 11) quotes from *Buck v. Helvering* (CCA-9) 73 Fed. (2d) 760, overlooking, apparently, that that case *decides* no more than that where the corporation *paid* its debt, before it was *paid* by the stockholder, the liability of the stockholder was extinguished as of the date of decedent's death.

In our present case, the debt for which Mrs. DuVal was liable *has not been paid* by the Corporation and it is, as it was when she died, still an active liability.

Finally, we submit that if the *Buck* case held that a claim is potential "until it is *paid* by the estate, or is reasonably certain that it must be *paid,*" it is contrary to the statute and the weight of authority construing its meaning, because deductibility has nothing to do with payment or payability, as we have shown at pages 17-19 of our opening brief.

> *Buck v. Helvering,* supra, held (73 Fed. (2d) p. 762):
>
> "* * * we hold that the *payment* by the corporation of its indebtedness should be considered as satisfying the claim against the estate as of the date of the death of the deceased. * * *"

But, suppose, in that case, as in the case at bar, *the claim had not been paid by the principal debtor?*

That is what was *not decided* by *Buck v. Helvering,* and that is why we say that that case is not controlling here.

It may very well be that where a claim, presented against an estate, is paid during administration by the principal debtor, it is satisfied to the extent of payment, as of the date of death. But where it is not so paid and *liability remains,* the same result does not follow.

V.

RESPONDENT QUOTES FROM THE PARROTT CASE, IGNORING THE FACT THAT IT STATES A RULE WHOLLY UNSUPPORTED BY THE LAW OF CALIFORNIA WITH REFERENCE TO THE GUARANTOR'S ALLEGED OBLIGATION TO A CO-GUARANTOR.

At page 32 of our opening brief, we quoted from *Parrott v. Commissioner* (CCA-9) 30 Fed. (2d) 792.

At page 16 of respondent's brief, will be found the identical quotation, minus the citation of the three cases from Massachusetts, Arkansas and Indiana upon which the Court relied to support its conclusion that in that case decedent's brother had a "contractual obligation" to pay his half of the debt.

At pages 32-33 of our opening brief we analyzed these three cases pointing out that whereas these cases correctly state the law of Massachusetts, Arkansas and Indiana that rights over exist from the time when a guaranty is executed, but this is *not the law in California,* where the law is settled that *unless and until the guarantor actu-*

ally pays the debt, no rights over exist. (See our Opening Brief, pp. 30-32.)

Whatever the law in other jurisdictions, since 1878 Section 1432 of the California Civil Code has provided:

> "A party to a joint, or joint and several obligation, *who satisfies more than his share of the claim against all, may require a proportionate contribution from all* the parties joined with him."

If there is a "right over" which must be included in decedent's gross estate as an asset, *it can hardly be included if it was not in existence as of the date of decedent's death. Skinker,* 13 BTA 846, *Rodiek,* 33 BTA 1020, *U. S. v. Safety Car & Lighting Co.,* 297 U. S. 88.

No requirement for the uniform application of federal tax laws can justify the inclusion in this decedent's gross estate of assets which did not exist as such in California as of the date of decedent's death.

We admit that all *assets* of the decedent must be included in the gross estate under I.R.C. Sec. 811.

But here we must look to the law of California to see if those assets exist.

As stated in *Rabkin & Johnson* on *Federal Income, Gift and Estate Taxation,* p. 3942 (p. 1, Sec. 12):

> "* * * Where the tax statute expressly or impliedly prescribes the taxpayer's property right as the test of taxability, then the *existence of that right must be discovered under the controlling local law. Blair v. Commr.,* 300 U. S. 5; *Helvering v. Stuart,* 317 U. S. 154, see *Magruder v. Supplee,* 316 U. S. 394; *Commr. v. Park,* 113 F(2d) 352 * * *"

At page 18 of respondent's brief appears a quotation from *Estate of Parrott,* 199 Cal. 107, 112. But the quotation omits this language of the case:

> "The fact that the note, as between the payors and the payee, possessed the potentialities of an enforceable demand against either of the debtors, affected his or her estate *only in the proportion that he or she was* required to pay it. The amount that the estate *was required to pay* on said obligation was the amount of the estate's indebtedness. *No greater demand than was paid by the estate was enforceable against it.* * * *"

The italicized portions of this statement are very significant in view of the facts stated by the Court, viz.—that on January 9, 1925, pending settlement of the estate, the decedent's brother *paid his one-half of the debt* and on March 10, 1925, the heirs and successors in interest of decedent paid $130,932.75 of the balance due on the debt and agreed to pay the balance to the noteholder and indemnify decedent's brother from any liability thereon.

The *Parrott* case can mean no more than the *Buck* case, viz.—that *payment* of a claim, during administration, by a principal debtor, satisfies the claim to the extent of payment as of the date of death. But, in the case at bar, there was no extinguishing payment. While under *Reg. 105,* Sec. 81.36, all claims against the estate are determined as of the date of decedent's death, the *actual amount* of the claim may not be known until some time afterwards. Thus a claim may be *filed* for a given amount and *allowed* and *approved* for another and *lesser*

sum. In the *Buck* and *Parrott* cases the Courts held that the *payments* made during the period of administration by a principal debtor and by a joint obligor respectively, had the effect of *reducing the indebtedness* as of the date of decedent's death by the amount paid. But where, as in the case at bar, there has been no such payment, there is no justification for the conclusion that the claim was "potential". We respectfully submit that the statements in the two cases *beyond what was actually decided therein* is dicta and where the indebtedness existing at the time of decedent's death is *not actually reduced by payment,* the two cases are not controlling.

VI.

THERE WAS NO RIGHT OF "EXONERATION" EXISTING IN DECEDENT'S FAVOR ON THE DATE OF HER DEATH OR AT ALL WHICH IS INCLUDIBLE IN HER GROSS ESTATE.

There was no right of exoneration existing in decedent's favor under Sec. 2846 of the California Civil Code.

This case involves absolute and unconditional guarantees.

In *McDonald v. Gravenstein, etc., Assn.*, 42 Cal. App. (2d) 329, 108 Pac. (2d) 936 (cited at page 23 of our opening brief), the Court said:

> "* * * The promise to pay is *absolute* and *unconditional; therefore* the liability of the guarantor is fixed when the principal obligation matures and it *is not predicated upon the exhaustion by the creditor of his remedy against the original debtor* (13 *Cal. Jur.* Sec. 22, p. 110). * * *"

In *Everts v. Matteson* (1942) 21 Cal. (2d) 437, at 445 the Supreme Court of California said:

> "As to contracts of guaranty made *prior* to the abolishment of the distinction between sureties and guarantors (Stats. 1939, ch. 453, sec. 10), the courts of this state have many times declared that the obligation of the principal debtor and that of the guarantor are entirely independent obligations. (*Bank of America v. Hunter,* 8 Cal. (2d) 592, 598 (67 P. (2d) 99); *Loeb v. Christie,* 6 Cal. (2d) 416, 420 (57 P. (2d) 1303); *Cooke v. Mesmer,* 164 Cal. 332, 340 (128 P. 917); *Adams v. Wallace,* 119 Cal. 67, 70, 71 (51 P. 14); *Ingalls v. Bell.* 43 Cal. App. (2d) 356, 366, 367 (110 P. (2d) 1068); *Rice Securities Co. v. Daggs,* 63 Cal. App. 273, 275 (218 P. 484); *Imperial Water Co. No. 4 v. Meserve,* 62 Cal. App. 603, 610 (217 P. 548); *Kelley v. Goldschmidt,* 47 Cal. App. 38, 42 (190 P. 55); *Withers v. Bousfield,* 42 Cal. App. 304, 319 (183 P. 855).) 'A mortgage or a trust deed given to secure the performance of an obligation to pay money and a guaranty given for the same purpose are each intended, of course, to subserve the same purpose, and where both are given to secure one single obligation of that character, the one operates merely as additional security to the other. *But the creditor may resort either to the one or the other to enforce the payment of the money to secure the payment of which both were given.*' (*Kelley v. Goldschmidt,* supra.) As a consequence of this distinction, the courts have held that the creditor may proceed against the guarantor upon the contract of guaranty without first resorting to the trust deed or mortgage security. (*Loeb v. Christie,* supra; *San Francisco etc. Seminary v. Monterey etc. Co.,* 179 Cal. 166, 172 (175 P. 693); *Cooke v. Mesmer,* supra; *Adams v. Wallace,* supra; *Ingalls v. Bell,* supra; *McDonald v. Gravenstein*

Apple Growers Cooperative Assn., 42 Cal. App. (2d) 329, 332, 333 (108 P. (2d) 936); *California Bank v. Kenoyer*, 2 Cal. App. (2d) 367, 369 (37 P. (2d) 836); *Kelley v. Goldschmidt*, supra; *Murphy v. Hellman, etc. Co.*, 43 Cal. App. 579, 586 (185 P. 485); *Withers v. Bousfield*, supra. *A surety, however, could require the creditor to first resort to the trust deed or mortgage security.* (Civ. Code, secs. 2845, 2850; and see cases collected in 23 Cal Jur., Suretyship, secs. 5, 56, 57).)''

The $162,000 note guaranteed by decedent and the guaranty thereon is dated August 17, 1937 which was before the abolishment of the distinction between sureties and guarantors in 1939.

Furthermore, the guaranty of the 1941 note provides expressly (Tr. pp. 8-9)

> ''I also hereby waive * * * (b) the right to require the holder to proceed against the maker, or to pursue any other remedy in the holder's power. * * *''

VII.

RESPONDENT IS UNABLE TO JUSTIFY THE TAX COURT'S EXCLUSION OF THE TAXPAYER'S OFFERED EVIDENCE AS TO THE FAIR MARKET VALUE OF THE ALLEGED RIGHTS OVER.

We are told (Resp. Br. p. 14) that there can be no dispute that the value of decedent's rights over were ''worth'' the full amount of the contingent liability.

Their position apparently is that the finding that at the date of decedent's death and since, both the maker of the notes and the co-guarantor have been solvent is a

finding that the rights over have a "fair market value" equal to the obligation.

But, this ignores the requirement that assets are included in the gross estate on the basis of "fair *market* value" and "market" connotes the idea of a value based on a *sale* in the market. *Reg. 105,* Sec. 81.0(a) so provides and states that

> "* * * The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell. * * *"

This necessarily means: If the guarantor had paid the debt, or more than her share of it, *at what price could she, under the formula, sell her rights over?*

It should be noted that her right of subrogation is a *right to a law suit* (*Jack v. Wong Shee,* 33 Cal. App. (2d) 402, 92 Pac. (2d) 499). And at page 20 of respondent's brief, respondent quotes from *Eastin v. Roberts, Carpenter & Co.,* 19 Cal. App. (2d) 567 which tells us that a right of exoneration gives the guarantor *a right to sue* the principal debtor.

Any one who purchased rights over would necessarily discount them heavily, *if such rights existed,* for there is relatively little value to a law suit. (See *Champlin v. Commr.* (CCA-10) 71 F. (2d) 23.)

Respondent evidently sees the difficulty of evaluating non-existent rights. At page 17 of respondent's brief it is said that the witness Kittrelle should have been asked this question:

> "* * * The expert should have been asked what he would value the rights over if, regardless of these rights, he was already under an unconditional obligation to pay the notes. * * *"

This confused statement, we submit, shows a failure to understand what could be offered for sale in California. Under California law, there would be no rights over to sell unless the guarantor first paid the debt.

Respondent says (Resp. Br. p. 14) that the Tax Court did not need expert testimony to value the rights over, citing *Doernbrecher v. Commissioner* (CCA-9) 95 Fed. (2d) 296. All that case holds is that the Board is not bound by expert testimony.

We claim that we were entitled to be heard on this question of fair market value unless the Court held that the rights over were not in existence.

We grant that once the Tax Court ruled on fair market value after hearing the evidence, the determination would bind us. But, the Tax Court never made a finding on that subject.

VIII.

IT IS NOT THE LAW THAT "SUBSEQUENT EVENTS WHICH SERVE TO DECREASE OR INCREASE THE AMOUNT THE ESTATE HAS TO EXPEND MAY BE TAKEN INTO CONSIDERATION".

What respondent means by the above statement which appears at page 10 of his brief evidently is that in two cases cited, the *Buck* case and the *Parrott* case, the *payment* of the claim by the principal debtor during the

period of administration in whole or in part extinguished the claim to the extent of payment, as of the date of decedent's death.

In the case at bar there was no such payment.

At pages 20-21 of our opening brief will be found a citation of the cases which settle the proposition that decedent's estate is settled as of the date of his death and what happens later has nothing to do with the case.

IX.

UNDER THE RATIONALE OF THE WRAGG CASE THE CLAIM IS ALLOWABLE IN FULL.

Wragg v. Commissioner (CCA-1) 141 Fed. (2d) 638, says:

> "* * * but when it has appeared that the right over was valueless a deduction for it (i.e. the claim) *has been allowed* * * *".

The rationale of this case is simply this: the claim may be deducted *to the extent that the rights over lack fair market value.* When the rights over are valueless, the claim is deductible in full.

Surely, the non-existent rights over which attached to these guarantees as of the date of decedent's death were valueless and justify a full deduction of the claim.

Respondent at page 9 of his opening brief mistakes the rule of the *Wragg* case, referring to

> "* * * the rationale of the rule that no deduction can be taken for secondary or accessory liability unless the rights over are included in the gross estate. * * *"

That, we submit, is *not* the rule of the *Wragg* case. *To the extent that the rights over have value* they must be included in the gross estate. If they have no fair market value, presumably they would be included at a value of "nil".

We are not trying to becloud the issues by raising technical niceties, as respondent suggests.

We *are* insisting that a realistic rather than a theoretical view be taken of this matter of "rights over" under the California law.

X.

IF THE CONGRESS IN ENACTING SEC. 812(b)(3) FAILED TO PROVIDE FOR SUCH AN UNUSUAL CASE AS THIS, THERE IS STILL NO JUSTIFICATION FOR JUDICIAL LEGISLATION.

Respondent suggests that if there were a third co-guarantor who died, each could claim a deduction without having paid the debt. This, it is claimed, would be an absurd result.

It may very well be that Congress did not think of the situation which has arisen in this case. As stated in 50 *Am. Jur.* p. 391, Sec. 380:

> "* * * An omission or failure to provide for contingencies which it may seem wise to have provided for specifically, does not justify any judicial addition to the language of the statute. To the contrary, it is the duty of the courts to interpret a statute as they find it without reference to whether its provisions are wise or unwise, necessary or unnecessary, appropriate or inappropriate, or well or ill conceived * * * ."

If there *is* anything absurd about this case, it is the Tax Court's construction of the bank's consent to distri-

bution as a release of the claim. Surely, in view of the record, that is an absurd conclusion.

XI.

THERE IS NO ELEMENT OF GIFT INVOLVED IN THIS CASE.

Respondent says (Resp. Br. p. 21) "that if we adopt petitioners' reasoning, at the time of decedent's death a liability existed but decedent had no recourse over since her rights had not ripened. Without recourse the transaction was a gift and not deductible under Section 812(b)(3)".

Although at decedent's death she had no rights over under the law of California, she was not without protection. If and when in the future the guaranty were paid, there would *then* be rights over under our law.

These were commercial guarantees required by the bank. The fact that under California law there were no rights over which existed as of the date of decedent's death does not make the case one of gift.

This is not a case where the decedent sought to diminish her taxable estate by creating obligations not meant correspondingly to increase it (1 *Paul* on *Federal Estate & Gift Taxation,* p. 692, Sec. 1120).

CONCLUSION.

Petitioners respectfully submit that the claim was fully deductible and that this Court may arrive at its own conclusions as to matters of law and in view of the clear cut

errors in law pointed out by petitioners this Court should hold as matters of law:

1. That the consent to distribution was what its name implies and not an abandonment of the bank's claim or a waiver of the bank's right.

2. That since there were no rights over having a fair market value and existing as of the date of decedent's death, the claim based on the absolute and unconditional guaranty imposed a primary liability and was deductible in full from the gross estate.

3. That it was error for the Tax Court to exclude petitioners' proffered evidence of the fair market value of the rights over.

4. That it was error for the Tax Court to impute an intent to the bank to abandon its claim and relinquish its right while disregarding the uncontradicted testimony to the contrary and in the absence of making a finding of fact that the bank so intended.

The *Parrott* and *Buck* cases are not applicable here because here there has been no payment of the debt by the principal debtor or by a co-guarantor.

Under the rule of the *Wragg* case, the rights over, being non-existent, had no fair market value and it was therefore proper to deduct the claim in full.

Dated, Oakland, California,
August 20, 1945.

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